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STATEMENT PRESENTATION

By CORINNE CHILDS, C.P.A., Tulsa Chapter, A.S.W.A.

The subject "Statement Presentation" would seem to require no particular definition of terms, but, possibly, we should consider some changing concepts in our meaning, even though we limit it to financial statements. Or perhaps you might like to think of an alternative topic which suggests itself, namely "Financial Reporting."

Let's go way back to some comments by Dr. Roy B. Kester in his book "Accounting Theory and Practice," published in 1917 for our starting point. Professor Kester did not refer to the plural of the word "statement"—instead, he wrote:

"The financial statement is designed to show the financial condition of a particular business at a given time. ***It marshals the assets in one list or schedule and the liabilities in another. The difference between the totals of the two schedules gives the present or net worth of the business. It is not sufficient in making a financial statement to give simply the figures of proprietorship or net worth, but schedules must be drawn up to show the items that make up that net worth."¹

This part may shock you. Concerning what we know as the income statement, he wrote:

"The profit and loss summary is known usually as the 'Profit and Loss Statement', though other titles such as Loss and Gain, Income, Income and Expense, and Business Statement are frequently used. Showing as it does, the manner in which the net worth has been changed, it amplifies, it fills out the record shown by the financial statement. The profit and loss summary is a supplementary record because it gives additional information, and is complementary to the financial statement because it rounds out and completes the story of business life there recorded."²

That briefly describes statement presentation in 1917, some 40 years ago, as viewed by that eminent authority.

The next 20 years (the period including World War I, the hey-day of the 20's, and

the dark days of the early 30's) also brought about some marked changes in the concept of our subject. For our authority, let's look at the "Accountants' Handbook," edited by W. A. Paton, the second edition being published in 1932. First of all, we note a recognition of the view that the income statement might not be, after all, a mere supplementary record:

"The two principal accounting statements are the balance sheet and the income sheet.^{***} Some authorities recommend, in addition, the use of a surplus statement or analysis to supplement the main financial exhibits. This practice, however, is of doubtful merit. On the whole it is preferable to include the surplus analysis and reconciliation as a final section of the income sheet.^{****}"³

We do know that the editor recognized that variations in the grouping of income sheet items are many, but he suggested a most detailed outline for the income statement. He suggested various subtotals such as gross profit, operating income, total net income, and net earnings before arriving at the net income figure.

As a current work, containing much useful information for accountants, either public or private, may I suggest "Report Writing for Accountants" by Jennie Palen, one of our own members, and published in 1955. Miss Palen wrote as follows about financial statements:

"When accountants speak of financial statements they usually mean, as to a commercial or industrial enterprise, a statement, however described, which purports to show financial position and a statement or statements, however described, which purport to show the results of operations. Any footnotes necessary to make the statements fair presentations of the matters are an integral part of the statements, even though they appear for convenience, on a separate sheet or sheets. As used herein, then, the term financial statement means

¹Roy B. Kester—ACCOUNTING THEORY AND PRACTICE. Copyright 1917 The Ronald Press Company. p. 26

²Roy B. Kester—ACCOUNTING THEORY AND PRACTICE. Copyright 1917 The Ronald Press Company. p. 43

³ACCOUNTANTS' HANDBOOK, Second Edition, edited by W. A. Paton. Copyright 1932 The Ronald Press Company. p. 3

(1) a balance sheet and (2) a statement of income and surplus or separate statements of income and of surplus.***"⁴

Further current references and "musts" for professional accountants are, of course, the bulletins and publications of the American Institute of Certified Public Accountants. Most of us here today know something of the activities of the American Institute in connection with accounting procedures and financial reporting. Since its organization the Institute has from time to time issued a series of opinions in its Accounting Research Bulletins.

During the period from 1938 until 1953 there were some 42 of these bulletins. Of necessity, of course, in that period some of them became of doubtful value. So we have Bulletin 43, "Restatement and Revision of Accounting Research Bulletins," which was issued in 1953. Bulletin 43 eliminated what was no longer applicable, and condensed and clarified, revised and rearranged the materials in the first 42 bulletins.

With respect to the combined statement of income and earned surplus, Bulletin 43 calls attention "to the increased significance attributed to the income statement by users of financial statements and to the general tendency to regard the balance sheet as the connecting link between successive income statements." It points out that the combining of the annual income statement with the statement of earned surplus, "where possible, will often be found to be convenient and desirable."⁵

With this brief review of some representative published accounting works of the past 40 years, let us adopt the concept that financial statements are an end product of the accountant's work.

The balance sheet, by whatever name called, is a snapshot, for it reveals the financial position of the entity for which it is prepared as of a particular instant of time, namely the end of the calendar or the fiscal year, or some other period.

The income statement, by whatever name called, is a motion picture of the entity for a particular period of time, for it

records moving history in the life of the business activity.

Just as it is necessary when we look at a snapshot, or even at a single reel of a motion picture, to have some explanation of the various details and actions recorded by the snapshot or movie, so is it necessary that a balance sheet and income statement have supplementary statements and information. It is in this respect that supporting schedules and financial notes achieve their significance. And, of course, as we all know, the traditional financial statements are frequently supplemented by other exhibits which are related to the main statements, and by supporting schedules which serve to give further details concerning the enterprise being photographed.

At one time in the history of financial reporting there was considerable discussion of the question: Whose financial statements are they? Phrased another, and perhaps better, way, the question was: Who has the responsibility for the preparation of the financial statements? In my opinion that question is fully answered as of this date, even though there are still those who believe that the independent accountant or auditor prepares the financial statement. Management is primarily responsible for the correctness of the financial statements. It was in the Interstate Hosiery Mills case that the Securities and Exchange Commission pointed out:

"The fundamental and primary responsibility for the accuracy of information filed with the Commission and disseminated among investors rests upon management. Management does not discharge its obligations in this respect by the employment of"—a firm of—"independent public accountants however reputable. Accountants' certificates are not required as a substitute for management's accounting of its stewardship, but as a check upon that accounting."

In her book, Miss Palen reminds the reader that the independent accountant or auditor merely expresses his opinion with respect to the financial statements prepared by management. She writes:

"The client has directed the accumulation of data upon which they (the financial statements) are based and has initiated the transactions which they record. The auditor may restyle the statements and often does so, but the basic data are the client's. The independent auditor's report consists of his opinion respecting the fairness of those

⁴Reprinted by permission from *Report Writing for Accountants*, by Jennie M. Palen, p. 30. Copyright, 1955, by Prentice-Hall, Inc., Englewood Cliffs, N. J.

⁵Bulletin 43, "Restatement and Revision of Accounting Research Bulletins", Copyright 1953, by the American Institute of Certified Public Accountants, p. 17

statements, together with any comments he makes regarding them.”⁶

As we accept the fact that financial statements are an accounting of the stewardship of management, then we should also recognize that the underlying function of the financial statements should be conceived by the accountant to be the presentation of significant information, whether the accountant be in public or private practice, about an enterprise to all interested parties, even though “significant information” may mean different things to each of them. Regardless of the purposes for which statements are prepared, there is one cardinal rule to be observed. Any statement prepared for any purpose should be a fair statement of what it purports to present, whether that be financial position and results of operations, or the amount of a payment due under a profit-sharing plan. Variations in length of statements or in manner of presentation are permitted, so long as we observe that rule.

Stated another way: There must be no misstatement of a material fact, and no omission of information necessary to make the statement not misleading; for once a report is issued, its use cannot be controlled.

If we pause to think of the question: For whom are statements prepared? we have difficulty in knowing where to stop. We could go on and on about statements for owners, statements for management, special reports for management, reports for credit purposes, reports for labor organizations and, of course, reports required by our governmental organizations and regulations.

It seems to me that the special reports for management, which may consist of such things as systems and procedures recommendations, reports of defalcations, computations of bonuses, and so on, offer the accountant the greatest opportunity for constructive service.

While there are those who would argue that we, as accountants, should prepare a single statement or series of statements—an accounting, if you please—which is all things to all men, it is not difficult for us, as accountants, to see that not all readers of a given set of statements can have the same interest, or seek the same information from statements. To repeat an earlier

admonition, inasmuch as, once any statement is prepared and issued, we cannot control its use and interpretation, we must be certain always that there is no misstatement of a material fact and no omission of information necessary to make a statement not misleading.

Progressing now to some current trends in statement presentation, let's look at some specific present-day tendencies in financial reporting.

First of all, you are reminded that each year for the past 10 years the American Institute of Certified Public Accountants has published a most valuable survey made by its research department and called “Accounting Trends and Techniques.” The 1956 publication is the tenth edition and it contains information on the published statements of some 600 industrial and commercial corporations, as well as excerpts from and comments upon unusual accounting treatments found in 700 additional reports, all with fiscal years ending within the calendar year 1955.

It is now well established that it is seldom satisfactory for a reader to see only a balance sheet as of a given date and an income statement for the preceding 12-months period. In Bulletin 43 it is pointed out that:

“The presentation of comparative financial statements in annual and other reports enhances the usefulness of such reports and brings out more clearly the nature and trends of current changes affecting the enterprise. Such presentation emphasizes the fact that statements for a series of periods are far more significant than those for a single period and that the accounts for one period are but an installment of what is essentially a continuous history. In any one year it is ordinarily desirable that the balance sheet, the income statement and the surplus statement be given for one or more preceding years as well as for the current year.”⁷

There is a continuing trend toward the use of comparative statements with approximately 70 per cent of the customary certified statements being presented in that form in 1955 as compared with only 34 per cent in 1946.

Having recognized the prevalence of comparative summaries in current pub-

⁶Reprinted by permission from *Report Writing for Accountants*, by Jennie M. Palen, p. 29. Copyright, 1955, by Prentice-Hall, Inc., Englewood Cliffs, N. J.

⁷Bulletin 43, “Restatement and Revision of Accounting Research Bulletins,” Copyright 1953, by the American Institute of Certified Public Accountants, p. 43

lished reports, we may now look at the language of these reports. No longer do reports adhere merely to the terminology of the professional accountant: there is a definite trend toward the use of "layman's language."

We can generalize here to the extent of saying that published annual reports are being prepared more from the standpoint of clarity and simplicity for the reader, and less from the viewpoint of what may be thought the highly technical and stilted language of the professional accountant. We find that there is a tendency toward less detail in book figures and greater emphasis on operational statistics.

This generalization is not intended to convey the impression that we, as accountants, are deviating from the generally accepted accounting principles that our profession has labored so diligently to establish, nor is it meant to question the reliability of the product of the accountant's labors. We have not put aside our basic requirements of, first of all, statements prepared in conformity with generally accepted accounting principles; and second, accounting principles consistently observed in the current period in relation to the preceding period.

Even though we have not put aside these basic requirements, we have, as accountants, heard the clamor of the public for readable and understandable statements designed to give the greatest possible degree of information concerning the business being reported.

For example, is there any real significance in the use of exact cents in most reports? There was a time in the not too distant past when it was felt that the use of exact dollars and cents in published reports indicated strict compliance and that their use assured competence on the part of the accountant and confidence on the part of the reader. Actually, that reasoning was not consistent with our provisions for items which admittedly were not definitely ascertainable, such as depreciation, depletion, amortization, uncollectible accounts, and so on.

In his recent article, "An Executive Looks at Accountancy," the former treasurer of R. H. Macy & Co. made some positive suggestions. He said:

"Reports should be in round figures, stopping with the last significant figure to avoid appearance of exactness."

He wrote further:

"For their own protection, it would seem

wise that accountants inaugurate a campaign to break down the generally accepted reputation for infallibility which is accorded them."

He said further:

"Accountants should take a broader view of themselves and their responsibility to the public than most of them seem to do. *** Their difficult task is to educate the public that their reports are based on estimates, and the nature and degree of those estimates should be fully explained and emphasized. It would seem useful if they could concentrate on giving the kind of reports that the readers of those reports need, rather than confine themselves to their own techniques and methods."⁸

Many authorities feel that the omission of cents and some of these other modernizations we are talking about savor of carelessness or inaccuracy. Nothing could be farther from reality. Rather, this trend makes for greater clarity and understanding when we accept the fact that accounting is not an exact science. It is "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."

Think about it. Is a balance sheet still a balance sheet? The majority of the companies included in the 1956 "Trends and Techniques" survey used the term "balance sheet" to describe the statement of assets, liabilities, and stockholders' equity. But you may be surprised to know that there is a trend toward the use of the terms "financial position" or "financial condition" in the balance sheet heading. This trend is due in part to the increased adoption of the "financial position" form of balance sheet, rather than the customary form. In the "financial position" form the net assets are shown equal to stockholders' equity, as distinguished from the "customary" form in which the assets are shown on the left, liabilities and stockholders' equity on the right.

Another significant recent development in statement presentation is the emphasis, as already hinted, on the importance of the income and retained earnings statements. All but three of the 600 corporations included in the 1956 survey provided the income statement in some form. Approximately two-thirds of these companies used a separate statement of income with the

⁸Oswald W. Knauth, "An Executive Looks at Accountancy" The Journal of Accountancy, January 1957, p. 29

remaining one-third using combined income and retained earnings statements. The past 10 years have seen a moderate trend toward adoption of the combined income and retained earnings statement.

In connection with this trend it is noted that the word "income" is the one most commonly used as the key word in the title of income statements; but we should be aware of the fact that recent years have seen a wider acceptance of the key word "earnings" in the income statement, with a continuing decrease in the use of the words "profit and loss."

There are two general types of income statements now in use in published reports, the multiple-step form and the single-step form. The older of these and still the more prevalent is, of course, the multiple-step form which contains the conventional grouping of items with intermediate balances.

The single-step form, on the other hand, consists of an income grouping over a single total and an expense grouping over a second total. However, many companies vary the use of each form in that they use a separate last section to set forth various tax or nontax, or both tax and nontax, items.

While the single-step income statement presents a less "cluttered" picture for published report purposes, it is frequently criticized for its failure to provide sufficient detail to enable the reader to ascertain the true results of the principal business activity of the entity. This criticism leads us back to one of our earlier conclusions—the purpose of a given statement is truly a factor in statement presentation.

Two other statements frequently found in published annual reports are the statement of source and application of funds and the statement of changes in working capital. The application-of-funds statement is the one likely to be of most interest and use to owners and management who may have difficulty in understanding the conventional financial statements.

Even a highly-successful businessman is not always able to read and understand a financial report. Thus we should not fail to recognize the needs of management, and particularly of that businessman who does not know how to understand and avail himself of the information in the usual balance sheet and income statement. To him, whether he be our employer or our client, we have an added responsibility of doing more than taking a picture of his business.

We need to give a third dimension, cinema-scope, if you will—to that picture.

It is the source and application of funds statement which frequently will best suit our purposes; nor do we need to use that formal title for it either. You might call it source and disposition of funds, or you might call it employment of funds. One report recently called it statement of cash flow. Another one called it statement of business activities, and an unpublished one contained a statement which was captioned, "Where it came from" and "Where it went."

No discussion of statement presentation or financial reporting would be complete if it did not point out some of the important areas of controversy today. One question that comes to my mind is: Should income be charged with depreciation based on original cost of the fixed assets, or should it be based on the replacement cost thereof?

A second current area of controversy is: How should the liability for past service pension costs be reflected on the books? Accounting Research Bulletin Number 47, issued last September, indicates some guides which are deemed to be acceptable for dealing with costs of pension plans in the accounts and reports of companies having such plans. But many questions in connection therewith are still unanswered.

A third current question, another related one, is: What effect, if any, should be given to the influence of changing price levels, particularly in inventory valuation for statement purposes? The Lifo method of inventory valuation has been determined as one approach to the problem of imperfect results when price levels change. Direct costing is another currently popular theory which affects the inventory valuation.

Concurrently, in the event changing price levels are recognized in inventory valuation, then should comparative summaries be adjusted for these changes in price levels? For an excellent current discussion of this problem take a look at the article in the May 1957 issue of *The Journal of Accountancy*, entitled "Accounting Measurements of Economic Concepts."

Another important area of controversy is: Should "out of period" income and expense items be included in current operating results? Stated another way, we have the problem of current operating performance versus all-inclusive or clean surplus theories in income reporting.

We designate the all-inclusive income statement as the one in which net income is defined by the inclusion of all items affecting the net increase in proprietorship during the period except dividend distributions and capital transactions. Miss Palen refers to this theory as the "clean surplus" theory.

The other income statement concept places its principal emphasis upon relationship of items to the operations of a given year, excluding from the net income any material extraordinary items which are not so related. This is sometimes referred to as the "current operating performance" basis.

There is, it would appear, a trend toward usage of the all-inclusive income statement. Admittedly, "materiality" is the deciding factor. Going back to Bulletin 43 again:

"There should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption relates to items which in the aggregate are material in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period."⁹

Another area of controversy concerns the ever-present matter of income taxes. What should be done about the allocation of income taxes for financial statement purposes when there are material differences between taxable and financial income?

Those are just some of the questions, some other areas of controversy, to point up again our expanding horizons.

A rather well-known financial writer, recently called accountants students of the past. He said it was our business to make

⁹Bulletin 43, "Restatement and Revision of Accounting Research Bulletins," Copyright 1953, by the American Institute of Certified Public Accountants, p. 63

autopsies, not forecasts. He classified us as undertakers, not doctors. Maybe we have brought that on ourselves by our failure to use originality and imagination in financial reporting.

Let's make our financial statements something more than glorified trial balances. How can we do this? By continuing to study, by reading the wealth of available material on accounting procedures, by observing available published reports, and by participating in the technical meeting opportunities available to us from time to time.

As accountants, we are in an enviable position for rendering valuable assistance to our employers and our clients. Someone has said that the accountant knows all about what has happened, something of what is happening, and even a little of what probably will happen next. Having this knowledge gives us no right, though, to presume that we are thereby qualified to decide what to do and how to get it done. We have a joint responsibility with management.

Perhaps it is appropriate to repeat the words of Howard C. Greer in a paraphrase of Sir Walter Scott:

"Breathes there the accountant, with
soul so dead
Who never to himself has said:
"The boss is sure a stupid Joe?"
Whose heart has ne'er within him
burned
To prove how much more could be
earned
If they'd just let him run the show?
If such there be, go, mark him well,
He's been around enough to tell
That even if you know it all,
Good management is something more
Than calling strikes and keeping score:
You also have to hit the ball!"¹⁰

¹⁰Howard C. Greer, *The Accounting Review*, April 1954, p. 175